# COUNTY OF SAN BERNARDINO, CALIFORNIA

MANAGEMENT LETTER

JUNE 30, 2006

Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants

VALUE THE DIFFERENCE

December 20, 2006

To the Board of Supervisors
Audit Committee
County of San Bernardino, California

Ladies and Gentlemen:

We have audited the basic financial statements of the County of San Bernardino (the County) for the year ended June 30, 2006 and have issued our report thereon dated November 20, 2006 (except for note 23 as to which the date is December 20, 2006). In planning and performing our audit of the basic financial statements of the County, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

## YEAR-END CLOSING PROCEDURES

**OBSERVATION:**

The County utilizes trust and agency funds as clearing accounts to distribute financial resources to other funds of the government, as well as other outside entities. For example, the County apportions pooled investment interest income and distributes the income to other County funds as well as to other governments within the County. When this occurs, the portion of the clearing account balance that pertains to other funds of the County, such as cash and cash equivalents, should not be reported in agency funds at June 30, rather, it should be reported as assets in the appropriate County fund in accordance accounting principles generally accepted in the United States of America.

During our testwork over accounts receivable, we noted the County recorded significant "due from other fund" receivable balances in the governmental funds. Based on our inspection of supporting documentation, it was noted that the County is accruing revenue and the related receivable in the fund financial statements for cash balances that exist in trust and clearing accounts.

**RECOMMENDATION:**

We recommend that the County establish procedures as part of year end closing to analyze "due from other fund receivables" to ensure all assets reported in trust and agency funds that pertain to other funds of the County are property reported as such. In addition, this analysis should include secured, unsecured and supplemental property taxes, unapportioned investment income and federal and state revenues.

**MANAGEMENTS RESPONSE:**

We agree with this recommendation and will establish year end closing procedures to ensure all assets reported in trust and agency funds that pertain to other County funds are reported as such.

## INTERFUND LOANS RECEIVABLE

**OBSERVATION:**

During our testwork over the County's interfund loans, we noted the existence of significant loan proceeds reported in the County's RDA, Library and Transportation funds. Based on our inquiry with County management, the County has misclassified interfund loans as loan proceeds due to budgetary constraints placed on Special Revenue funds. In accordance with County budget policies, before an appropriation can be approved in a Special Revenue fund, there must be sufficient revenues to appropriate. As a result of classifying the loans as other financing uses, the County's Board approved the loans from the General Fund to the RDA, Library and Transportation fund. VTD noted in accordance with GASB 34, paragraph 112, all interfund loans between blended component units and other government funds must always be reported on the balance sheet, with no impact on the operating statement. We noted the County is correctly classifying the loans receivable in the General Fund. However, audit adjustments were proposed and recorded to reclassify the loan proceeds reported in the Transportation, Library and RDA special revenue funds to Interfund Loans Payable

**RECOMMENDATION:**

We recommend that the County establish procedures as part of year end closing process to analyze "loan proceeds" recorded in the funds to ensure all interfund loans are properly classified and recorded in the financial statements

**MANAGEMENTS RESPONSE:**

We agree with this recommendation and will establish year end closing procedures to analyze, properly classify and record all interfund loans in the financial statements.

## LANDFILL POST CLOSURE LIABILITY

**OBSERVATION:**

Generally accepted accounting principals state that landfill closure and post closure care costs are required to be estimated and accrued over the period in which the landfill accepts solid waste. The generally accepted method of recognizing the liability requires the County to take the ratio of the landfill's total estimated capacity and the cumulative capacity used and apply the ratio to the total estimated costs, adjusted annually for inflation. During our testing of the County's landfill closure and post closure care liability estimate, we noted errors in the calculations resulting in audit adjustments.

**RECOMMENDATION:**

We recommend that the County implement stronger internal controls to ensure the completeness and accuracy of the County's landfill liability estimates recorded in the County's financial statements.

**COUNTY'S RESPONSE:**

This was a one-time training incident. This has not been a repetitive incident, and SWMD does not anticipate it will be repeated in the future. An SWMD employee was being newly trained to perform this function, with their work reviewed by their supervisor. The errors were due to active site formula incompleteness. The most recent inflation factor inputted into the reference table was not included in the appropriate active site formulas.

For the future, the SWMD supervisor will do the final review of all formulas after the file has been forwarded from the employee, to ensure that all changes are saved to the version used for submission.

## STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS

### SOLID WASTE DIVISION - ACCOUNTS RECEIVABLE MANAGEMENT

**OBSERVATION:**

During our testwork over Solid Waste Division's (the Division) accounts receivable, the following observations were noted:

- As part of the closing process, the Division provides to the Auditor/Controller an accounts receivable aging report generated from the Solomon system. Prior to submitting the proposed accruals to the Auditor/Controller, Division staff reconcile the aging report to each customer account and classify the receivable balances for financial statement presentation. During our accounts receivable testwork, we noted the aging report submitted to the Auditor/Controller was generated on June 25, 2005. This was done to allow Division staff time to reconcile each customer account and meet established deadlines for submittal of year-end accruals. Although the aging report appropriately reflected the June 2005 billing, immaterial cash receipts collected from June 25 to June 30 were not posted to the aging report.
- The Division did not generate and review the accounts receivable aging report as of June 30, 2005. SWD staff indicated the Soloman system does not have the capability to go back to a specific date and generate a "historical" aging report. As such, the Division could not compare the June 25, 2005 aging report submitted to the Auditor/Controller to the June 30, 2005 aging report to ensure the completeness and accuracy of the aging report.
- The Division has an informal policy of holding cash receipts (checks) for customer accounts until the payment can be properly posted to the correct billing invoice. During our testwork, we noted an amount of $144,839 was not deposited in the County's bank account until two months after receipt from the customer. Consequently, the customer issued a stop payment on the check. As a result, the customer's account was not appropriately updated, thus overstating accounts receivable at June 30, 2005. It is also noted that $522,171 in cash receipts were collected 5 days prior to June 30, 2005, but not deposited. This same amount was not reported to the Auditor/Controller as part of the year-end closing procedures. Audit adjustments were proposed and recorded to correct the June 30, 2005 accounts receivable and cash on hand balance.
- During our accounts receivable testwork, we noted that both invoices and the offsetting credit memos were listed on the accounts receivable aging. In several cases, the Division has not consistently matched payments received against outstanding invoices. Additionally, it is noted that the Division has an informal policy of applying customer payments back to the same month the billing took place, irregardless of when payments are received. This above practice distorts the true aging of accounts receivable.

- During our testwork, we noted that management review of bank reconciliations were not evidenced or documented.

**RECOMMENDATION:**

We recommend that the Division design procedures to ensure that proper cut-off for accounts receivable is achieved, cash received is deposited in a timely manner and that payments received and credit memos issued should be matched against appropriate invoices and differences investigated and reconciled on a timely basis .

**STATUS:**

Partially Implemented – procedures have not been documented

## UNTIMELY PREPARATION OF ELECTRONIC BENEFIT TRANSFER (EBT) ACCOUNT CASH RECONCILIATION

**OBSERVATION:**

We noted that the Electronic Benefit Transfer (EBT) cash account from April 2005 through June 2005 had not been reconciled in a timely manner. Untimely reconciliation of cash accounts could cause any errors made by the bank or the County to go undetected in a timely manner.

**RECOMMENDATION:**

We recommend that the County put procedures in place to ensure that the EBT bank reconciliations are completed in a timely manner. In addition, these reconciliations should be reviewed by someone other than the preparer. By ensuring that these procedures are completed, the County will reduce the risk of cash being misappropriated and going undetected by management or their being errors on the financial statements.

**STATUS:**

Implemented

## DEBT MANAGEMENT

**OBSERVATION:**

It is noted the Auditor/Controller and CAO's office is charged with the responsibility of monitoring the County's outstanding long-term debt. This responsibility includes paying principal and interest when due, monitoring debt covenant compliance, monitoring arbitrage earnings, monitoring the related debt service schedules and reconciling trustee account activity. During our testwork we noted the County did not reconcile the third party trustee account activity related to the 2004 Pension Obligation Bonds to the general ledger. As a result, material adjustments were required to the general ledger to properly reflect the activity in the trustee accounts.

**RECOMMENDATION:**

We recommend that the County implement procedures to ensure the 2004 Pension Obligation Bond trustee accounts are properly reconciled in a timely manner.

**STATUS:**

Implemented

## MAINTENANCE OF HUMAN RESOURCE FILES

**OBSERVATION:**

During our testing of the Human Resource process, we noted several instances whereby employee's files did not contain original supporting records required as part of the audit process.

**RECOMMENDATION:**

We recommend that the County design procedures to ensure that employee personnel files are kept current and support the status and pay rate of employees. By maintaining employee files current it will reduce the risk of errors and irregularities occurring in payroll and going undetected by management.

**STATUS:**

Partially Implemented

## FEDERAL AWARD REPORTING

**OBSERVATION:**

During our examination of the County's procedures of compiling the Schedule of Expenditures of Federal Awards (SEFA) under the Office of Management and Budget (OMB) Circular A-133, it was noted that revenues are not consistently recorded between federal and state sources. In several circumstances, it was noted that federal revenue amounts were recorded within state revenue source object codes and visa versa. Although this practice does not misstate the County's revenues at the financial statement level, it does allow for the potential misstatement of expenditures under federal reporting requirements.

**RECOMMENDATION:**

We recommend that the County modify its procedures to classify current year revenues to be based on the proper allocation to either federal or state revenue source object codes. By implementing such a procedure, this would streamline the reporting process required under OMB Circular A-133 and provide additional control over the presentation of the SEFA.

**STATUS:**

Partially Implemented

## NEW FINANCIAL REPORTING AND AUDITING STANDARD EFFECTIVE FOR FISCAL YEAR 2006-2007

## INFORMATIONAL ONLY

### GOVERNMENTAL ACCOUNTING STANDARDS No. 43

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.* The standards in this Statement apply for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. This Statement also provides requirements for reporting of OPEB funds by administrators of multiple-employer OPEB plans, when the fund used to accumulate assets and pay benefits or premiums when due is not a trust fund. A related Statement, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (referred to as the related Statement), addresses standards for the measurement, recognition, and display of employers' OPEB expense/expenditures and related liabilities (assets); note disclosures; and, if applicable, required supplementary information (RSI). The measurement and disclosure requirements of the two Statements are related, and disclosure requirements are coordinated to avoid duplication when an OPEB plan is included as a trust or agency fund in an employer's financial report. In addition, reduced disclosures are acceptable for OPEB trust or agency funds when a stand-alone plan financial report is publicly available and contains all required information.

The requirements of this Statement for OPEB plan reporting are effective *one year prior* to the effective date of the related Statement for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of the related Statement are effective in three phases based on a government's total annual revenues, as defined in that Statement, in the first fiscal year ending after June 15, 1999—the same criterion used to determine a government's phase for implementation of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* Plans in which the sole or largest participating employer is a *phase 1 government* (those with total annual revenues of $100 million or more) are required to implement this Statement in financial statements for periods beginning after December 15, 2005. Plans in which the sole or largest participating employer is a *phase 2 government* (total annual revenues of $10 million or more but less than $100 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2006. Plans in which the sole or largest participating employer is a *phase 3 government* (total annual revenues of less than $10 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2007. If comparative financial statements are presented, restatement of the prior-year financial statements is required. Early implementation of this Statement is encouraged.

### GOVERNMENTAL ACCOUNTING STANDARDS No. 45

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* This statement addresses how state and local governments should account for and report costs and obligations related to postemployment healthcare and other nonpension benefits. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. The requirements of this Statement are effective for financial statements for periods ending after June 30, 2008.

**GOVERNMENTAL ACCOUNTING STANDARD No. 48**

In September 2006, the GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. Governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments—generally, a single lump sum. The financial reporting question addressed by this Statement is whether that transaction should be regarded as a sale or as a collateralized borrowing resulting in a liability. Historically, guidance for reporting the effects of those transactions in governmental financial statements either has been provided in several standards or, in certain cases, was not specifically addressed in authoritative literature. In addition, little or no information about pledged revenues was being disclosed in the notes to the financial statements. As a result, there has been considerable diversity in the manner in which these transactions and information about them have been reported.

This Statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. This Statement establishes that a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving *receivables* should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the change statements. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

This Statement includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred.

This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. The disclosures pertaining to future revenues that have been pledged or sold are intended to provide financial statement users with information about which revenues will be unavailable for other purposes and how long they will continue to be so. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2006.

**GOVERNMENTAL ACCOUNTING STANDARD No. 49**

In December 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of *existing* pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution *prevention* or *control* obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning.

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2007, with measurement of pollution remediation liabilities required at the beginning of that period so that beginning net assets can be restated. However, governments that have sufficient objective and verifiable information to apply the expected cash flow technique to measurements in prior periods are required to apply the provisions retroactively for all such prior periods presented.

**STATEMENT ON AUDITING STANDARDS No. 112**

The Auditing Standards Board has issued Statement on Auditing Standards (SAS) No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, which replaces SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit.*

This SAS establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements. It is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion).

Among other things, the SAS:

- Requires the auditor to communicate control deficiencies that are *significant deficiencies* or *material weaknesses* in internal control.
    - A *significant deficiency* is a control, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.
    - A *material weakness* is a significant deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

These definitions are consistent with PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*. The term *reportable condition* is no longer used.

This SAS is effective for periods ending on or after December 15, 2006.

**STATATEMENT ON AUDITING STANDARDS No. 104—No. 111**
**RISK ASSESSMENT STANDARDS**

The AICPA's Auditing Standards Board (ASB) has issued eight Statements on Auditing Standards (SAS) relating to the assessment of risk in an audit of financial statements:

- SAS No. 104, *Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures ("Due Professional Care in the Performance of Work")*

- SAS No. 105, Amendment to Statement on Auditing Standards No. 95, Generally
- Accepted Auditing Standards

- SAS No. 106, *Audit Evidence*
- SAS No. 107, *Audit Risk and Materiality in Conducting an Audit*
- SAS No. 108, *Planning and Supervision*
- SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- SAS No. 110, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- SAS No. 111, *Amendment to Statement on Auditing Standards No. 39,* Audit Sampling

These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by error or fraud) in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the Statements establish standards and provide guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit.

The primary objective of these Statements is to enhance auditors' application of the audit risk model in practice by specifying, among other things:

- More in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them.
- More rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
- Improved linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks.

In developing these Statements, the ASB worked in concert with the International Auditing and Assurance Standards Board of the International Federation of Accountants and, therefore, the project was representative of the effort among standard-setters to promote the convergence and acceptance of an international set of auditing standards. Finally, the Statements represent part of the ASB's ongoing effort to develop stronger and more definitive auditing standards that are intended to enhance auditor performance and thereby to improve audit effectiveness.

The Statements will be effective for audits of financial statements for periods beginning on or after December 15, 2006. Early adoption is permitted.

We expect these additional procedures to increase audit time slightly and require additional time of County personnel.

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Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the County gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Board of Supervisors, Audit Committee, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
December 20, 2006